KELMAN TECHNOLOGIES

Kelman Technologies Inc. 2003 Annual Report

KTI provides resource exploration and exploitation service companies with a comprehensive suite of seismic processing, technical services and data management services. KTI's vision is to provide customers with superior seismic data processing, archiving and data management services that help to manage client risk, improve service turnaround and reduce overall costs. KTI provides customized seismic solutions – we develop and customize technology to serve our clients' needs. The Company's common shares trade on the Toronto Stock Exchange under the symbol "KTI".

Financial Highlights

Years ended December 31	2003	2002
Revenue	**$ 24,570,924**	$ 28,585,702
Cash flow from operations	**$ 3,354,700**	$ 6,071,516
Net earnings	**$ 458,612**	$ 2,697,974
Per share	**$ 0.01**	$ 0.07
Long-term debt	**$ 390,226**	$ 3,112,315

A Year of Expansion

Letter to Shareholders

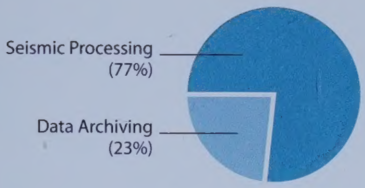
A Year of Expansion, Despite Difficult Market Environment

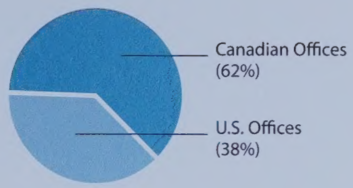
2003 was a year of continued expansion for Kelman. Specific as well as general expansion initiatives and events are as follows:

- **R&D group successfully patented some exciting new software and has applied for patents in others**
- **Signed a major contract for processing work out of Mexico**
- **Moved our Houston office into a larger, more efficient space and signed a long-term lease**
- **Increased our compute power in our Houston office to over 1000 CPUs, putting Kelman in position to bid for higher margin work that was unavailable to us without this capacity**
- **Opened a small office in Oklahoma City**
- **Increased our market share in Canada, our traditional base of strength**
- **Increased our seismic data under management by 50% to 60 terabytes**
- **Moved closer to securing a significant data management contract in the US with major independent oil company**

The effects from these expansion activities should begin to show through in the second half of 2004 and into 2005.

2003 Revenue





The results achieved in the year 2003 were also reflective of a difficult and changing market environment for the seismic industry. KTI responded by reducing staff levels by 10% during the year. A variety of factors influenced the exploration market and hence our seismic industry. Principal amongst these factors has been the much stronger than expected prices for oil and gas. While it seems counter-intuitive very high prices generally dampen exploration activity. Oil and gas producers, many with significantly increased capital budgets, will differentially spend such budgets on exploiting existing reserves in the hope that they can achieve increased short–term production rates. Exploitation will generally lead to large increases in the number of wells drilled but will use less seismic in the process. Additionally, the strength of the Canadian dollar had a dampening effect on Canadian exploration. Exploration, which was economic at $1.55 CDN to the US dollar, was significantly reduced at $1.30. However, at the same time, your Company benefited by a financial strategy set in place early in 2003. Under this strategy KTI was insulated from the negative effects of the decline in the US dollar.

In the face of expansion and a difficult market environment, for 2003 your Company has continued to improve its balance sheet. At the end of the year our conservative balance sheet showed very low long-term debt. However, the convertible preferred share issue of 7.8 million shares, which raised $5.1 million in 1999, will expire in 2004. Consequently, year-end working capital showed a significant reduction as the $5.1 million which had been seen as long-term debt had to be reclassified to current debt.

David A. Richard
President and CEO
April 30, 2003

Processing Division

Calgary

East Coast Canada marine activity levels slowed to even lower rates than 2002, which reduced KTI revenues from this sector. Also, the failure to finalize firm agreements for either a Mackenzie Valley pipeline or an Alaskan route pipeline resulted in lower than anticipated exploration activity in Canadian frontier regions. International work did increase marginally and this sector continues to grow as a percentage of KTI's overall revenue stream. The percentage of revenues derived from 3D work increased to 47% from 24% in fiscal 2002. Since this type of revenue generation is less reliant on man time than 2D work, we were able to reduce processing staffing levels by 22% in a continuing effort to reduce costs. Despite the lower overall revenue levels we were able to maintain enough R&D effort to make substantial additions to our overall 3D depth imaging and marine multiple suppression capabilities, which are expected to pay strong dividends in the future. The Calgary R&D team secured patent pending status on two new products that are expected to help KTI maintain a proprietary software advantage in these areas for some years to come.

Houston

US exploration and production companies continued to invest heavily in existing producing properties around the world. Domestic spending on geophysical land and marine work was extremely slow in 2003. The US and Houston competitive market continued to shrink as the larger service providers abandoned the smaller market areas and some companies went out of business. Market demand switched strongly to 3D depth imaging capabilities that require both strong proprietary software and large computational

power in order to win the projects. In the latter part of the year KTI invested in new Linux cluster hardware and in a new, expanded Houston facility. We now have over 1000 CPUs in our Houston office and we have recently added significant new processing capabilities in two critical areas; 3D marine multiple suppression and 3D depth imaging. To control short term costs staffing levels have been reduced significantly in the Houston office. Several companies have laid off some very talented people during fiscal 2003 and KTI hopes to be ready to expand by hiring very high quality staff when the time is right.

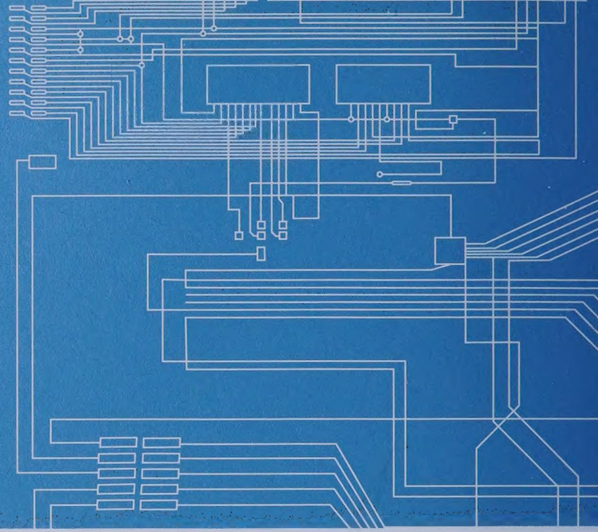
Denver

Denver revenues were well above projections for fiscal 2003 due to the winning of a major international contract. The Denver office has moved into larger premises to allow for some modest expansion of both staffing levels and computer power. Because of some very successful independent E&P companies in Denver, the general exploration activity level increased marginally in 2003 and is expected to expand further in 2004. It is our expectation that the US Rocky Mountain front will see an increasing amount of exploration activity in the next five years and KTI is well positioned to take advantage of this.

Oklahoma City

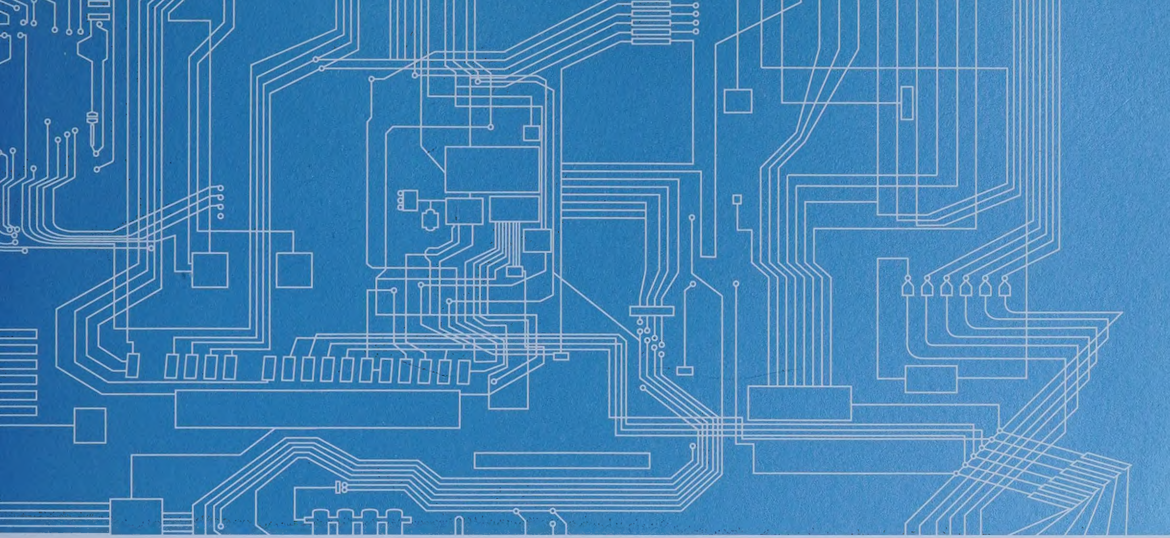
In the spring of fiscal 2003 KTI opened a small office in Oklahoma City. Some significant E&P companies continue to operate out of that city and that part of south central US is a very hot gas play area due to the anticipated continued strength of gas prices in the years to come. KTI's strong reputation for complex structure land processing has contributed greatly to the success of this office and we intend to continue to grow this office and find other small market opportunities as they arise.

Data Management and Archives Division



The Canadian Data Management Division performed to forecast throughout the first two quarters of 2003 but experienced a lull in the market in the third quarter. While revenues lagged through the quarter and only recovered partially in the fourth quarter, expense reductions mitigated much of the negative effects.

The Houston Data Management group continued to build through the efforts of our staff and expanded interest from our existing regional clients. The move by the Division to a new site has made a very positive impact on data throughput, organization and accessibility. More importantly, our current and prospective clients appear to be impressed by KTI's commitment to the Houston market. By year-end 2003 we were processing a large volume of data and were in negotiations with a major independent oil company for a very significant data management contract. These negotiations carried over to the new-year although work, on a project-by-project basis, is underway on their behalf.



Marketing efforts remain a key focus and 'KTI mind-share' continues to increase in the North American market as a whole. Further enhancement to our service offerings and process developments continue to give our client base a high tech advantage over many of their competitors. Clients have expressed support for our multi-layered approach to data storage. Under this model, data is accessible from on-line, near-line and off-line storage, depending on the wishes of our clients. This allows our clients to keep the most active data in a constant state of readiness for immediate electronic delivery and the less active data more economically stored off-line, but still able to be accessed within 'hours' rather than the 'days' more common in the industry.

Now that our entry into the US seismic data management market has been secured, development into other vertical markets has increased in priority. We are actively reviewing opportunities for data management outside of our domain expertise in seismic. Additionally, we are looking to expand our seismic data management model to other parts of the world, principally through strategic partnerships or alliances.

Outlook

Our outlook for the coming year is predicated on two things. The first is how much exploration activity will be conducted during the year and the second is KTI's market share of such work. Dealing with the second issue first, I am confident that we will continue our trend of the last few years in which we gained more than our traditional share of the markets in which we work. Additionally, new offices such as Oklahoma City, where we can identify the appropriate conditions, should allow us a presence in areas that previously offered us little opportunity.

The broader issue is how much exploration activity will there be in 2004. In this regard, our analysis and forecast for commodity pricing suggests that the prices for oil and gas will fall somewhat during the year to the range of $25 US per barrel. From our perspective this is seen as very good news as the price remains healthy giving Exploration and Production companies the money to fund exploration but without the incentive to seek short term production increases at the expense of long term reserve additions. Exploration in Canadian gas prone areas such as the foothills and northern permafrost areas is expected to increase from the levels seen in the last couple of years. In the US we foresee an increase in activity driven largely by the small to medium sized explorers.

In our opinion the greatest increase in exploration activity will occur outside of Canada and the US. KTI has done work for E&P companies on projects from countries all over the world. As worldwide demand for gas increases, the demand for complex structure land processing will increase in many areas around the world. The National Oil Companies in these countries are increasingly demanding that the high tech processing work be done in country so that their own people can become trained and they can eventually become technically more self-sufficient. In fiscal 2004 KTI will endeavor to grow revenues by leveraging its proprietary technology asset to gain on-the-ground entry into selected foreign markets.

Management's Discussion and Analysis

The discussion below, is an analysis of the consolidated financial results of Kelman Technologies Inc. (the "Company") for its fiscal year ending December 31, 2003. This discussion and analysis of the financial condition and results of operations has been prepared by management and should be read in conjunction with the accompanying consolidated financial statements and related notes, together with other information contained in this Annual Report. All amounts in this discussion are expressed in Canadian dollars.

Operating Results

(000s, except per share amounts)	2003	2002	Change
Net earnings	**$ 459**	$ 2,698	-83%
Per share (basic and diluted)	**$ 0.01**	$ 0.07	-86%
Cash flow from operations	**$ 3,355**	$ 6,072	-45%
Weighted average number of shares outstanding	**39,174**	39,080	

The Company had positive earnings and strong cash flow despite a year of significant expansion and a very difficult market environment, particularly in the Company's Houston based operations. Despite high oil and gas prices, exploration and production activity by our clients was weighted towards exploiting existing reserves, a process that requires less seismic information. This has to be a short-term phenomenon. Over time we expect the industry to focus on finding new reserves, which will require new seismic information.

Operating Revenue

(000s)	2003	2002	Change
Seismic processing			
Canada	**$ 10,307**	$ 11,241	-8%
United States	**8,538**	10,148	-16%
	$ 18,845	$ 21,389	-12%
Data archiving			
Canada	**$ 4,941**	$ 5,555	-11%
United States	**785**	1,642	-52%
	$ 5,726	$ 7,197	-20%
Total operating revenue	**$ 24,571**	$ 28,586	-14%

Canadian-based seismic data processing had an 8 percent decrease in revenues versus 2002 in a year in which many Canadian companies substantially lowered their exploration budgets.

US-based seismic data processing revenue decreased almost 16 percent in 2003. Houston seismic data processing revenues dropped by 49 percent to $4.5 million, down from $8.8 million in 2002. Denver seismic data processing revenues increased to $3.3 million, from $1.4 million in 2002. Denver was slow throughout the first 2 quarters, mainly as a result of our clients having lower exploration budgets, but picked up a major contract for processing work in the

third quarter of the year. The Company set up a new office in Oklahoma City in the first quarter of 2003, which had seismic data processing revenues of $764 thousand. In 2003, 45 percent of processing revenues were derived from the US offices, down 2 percent from 2002. The Company expects that at least 50 percent of future processing revenues will be derived from the US offices.

Revenue from the Archives Division in Calgary is earned from both archival and transactional services. In 2003, 70 percent of revenues were earned from archival services and 30 percent from transactional services. The Houston-based Archives Division revenues were down 52 percent from 2002 as the Company continued to introduce its proprietary product to the Houston market.

Operating Expenses

(000s)	2003	2002	Change
Operating expenses	**$ 20,834**	$ 21,936	-5%

The Processing Division experienced a 2 percent decrease in operating expenses compared to a 12 percent increase in 2002. Operating expenses in the Archives Division decreased 15 percent during the year compared to a 4 percent increase in 2002. The decrease in operating expenses is mainly attributed to staffing reductions.

The combination of salaries and occupancy costs account for 77 percent of the Company's total operating expenses, compared to 81 percent in 2002. Salaries as a percentage of revenue increased from 56 percent to 58 percent year over year.

Depreciation and Amortization

(000s)	2003	2002	Change
Depreciation and amortization	**$ 3,573**	$ 3,674	-3%

Depreciation and amortization for the year was lower due to decreased capital expenditures in the past couple of years.

Interest and Dividends

(000s)	2003	2002	Change
Interest on long term debt	**$ 175**	$ 348	-50%
Preferred share dividends	**330**	330	–
Total interest and dividends	**$ 505**	$ 678	-26%

Interest on long-term debt decreased as a result of lower debt outstanding during the year. Given that the Preferred Shares are subject to prescribed redemption, accounting rules dictate that dividends thereon are classified as interest expense.

Income Taxes

The Company has an unrecognized net future income tax asset totaling $17.0 million. This asset can be used to reduce taxable income in the next several years. The Canadian division has $1.3 million of non-capital losses that expire in 2006. To the extent that certain deductions from taxable income are discretionary, notably with respect to capital assets, the Company has the option of refiling prior year income tax returns so as to accelerate the availability of non-capital loss carry forwards. The US division has US$11.2 million in net operating losses expiring at various times until 2023.

Working Capital and Cash Balances

(000s)		**2003**		2002	Change
Working capital before preferred shares	**$**	**5,376**	$	5,032	7%
Preferred shares as a current liability	**$**	**(5,075)**		–	
Working capital	**$**	**301**	$	5,032	-94%
Cash position	**$**	**(1,474)**	$	(189)	-680%

Cash continued to be directed primarily to expansion activities, capital additions and paying down term debt during the year. The Company made 2 bullet payments on its term facility debt on December 31st totaling $1.5 million. Capital expenditures were $3.0 million, relating to setting up facilities in Oklahoma City and expansion in Denver offices, as well as development costs on proprietary software.

The Company used $3.1 million of cash for scheduled and non-scheduled bank loan payments. In addition, the Company increased the draw against its line of credit by $682,000.

Liquidity and Capital Resources

(000s)		**2003**		2002	Change
Total term debt outstanding	**$**	**245**	$	2,851	-91%
Total capital leases outstanding		**145**		261	-44%
Total debt	**$**	**390**	$	3,112	-87%

Total term debt decreased by $2.7 million. During the year $330,000 was added to the capital loan facility to fund computer hardware purchases, which was more than offset by the term debt repayments.

The Company has a credit facility with the Canadian Imperial Bank of Commerce consisting of an operating line of credit up to $5 million, of which $1.9 million was drawn at year-end, a bank capital loan facility up to $1.5 million, none of which was drawn at year-end and a US $1.0 million line of credit for foreign exchange contract contingencies. The Company also has 3 capital leases totaling $145,000 at year-end.

The Company expects to fund capital expenditures in 2004 through normal cash flow, bank operating lines and the use of capital lease facilities.

The Company maintains a conservative balance sheet and has no investments in any off-balance sheet ventures such as partnerships or joint ventures.

Risks and Uncertainties

The Company is engaged in seismic data processing and seismic data management. The demand for these services is somewhat dependent upon the level of expenditures in the exploration and production segment of the oil and gas industry. These expenditures are influenced primarily by the price of the commodity being produced. The Company is also subject to risk and uncertainty related to technological advances and direct competition within the data processing and data archival sectors.

With a continued commitment to product enhancement and value-added customer service the Company attempts to minimize risk in the seismic data processing realm by offering a sophisticated suite of proprietary products, applications in land and marine processing to customers located in countries around the world.

The Company's state of the art data management and archival line of business is not as directly affected by fluctuations in exploration activity. A flexible open system to meet client's specific needs provides an economical solution to seismic data storage, retrieval and management and as such is less dependent on capital exploration budgets. The Company has created residual revenues through long-term working relationships with clients, which help to minimize short-term volatility in the market.

In addition to historical information, this report contains statements which by their nature are forward-looking and which involve known and unknown risks, delays, uncertainties and other factors not under the Company's control. Any of these factors may cause actual results, performance or achievement to be materially different from the results, performance or expectations implied by these forward-looking statements.

Management's Report

The accompanying consolidated financial statements of Kelman Technologies Inc. and all information in the annual report were prepared by and are the responsibility of management. The consolidated financial statements have been prepared in accordance with accounting policies outlined in the notes to the consolidated financial statements and in conformity with Canadian generally accepted accounting principles.

Management maintains appropriate systems of internal controls designed to provide reasonable assurance that all transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of the financial statements.

The consolidated financial statements have been examined in accordance with generally accepted auditing standards in Canada by the independent accounting firm KPMG LLP whose appointment is ratified annually by the shareholders at the annual shareholders' meeting.

The Audit Committee of the Board of Directors, which is comprised exclusively of directors who are not employees of the Company, has reviewed the consolidated financial statements, including the notes thereto, with management and KPMG. The Board of Directors approved the consolidated financial statements on the recommendation of the Audit Committee.

David Richard
President and CEO

Seymour Epstein
Chairman

Blake Lyon
CFO

Auditor's Report

We have audited the consolidated balance sheets of Kelman Technologies Inc. as at December 31, 2003 and 2002 and the consolidated statements of operations, deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
February 20, 2004

Consolidated Balance Sheets

As at December 31		2003		2002
Assets				
Current assets:				
Cash	$	451,473	$	1,053,875
Accounts receivable		7,878,823		6,384,830
Work in progress		772,226		3,021,635
Prepaid expenses and deposits		433,086		311,440
		9,535,608		10,771,780
Property and equipment (note 2)		8,692,316		9,015,365
Other assets (note 3)		1,254,397		1,855,952
Future income tax asset (note 4)		1,800,000		1,000,000
	$	21,282,321	$	22,643,097
Liabilities and Shareholders' Equity				
Current liabilities:				
Bank indebtedness (note 5)	$	1,925,186	$	1,243,031
Accounts payable and accrued liabilities		1,893,760		1,888,214
Current portion of long-term debt		340,361		2,608,840
Preferred shares (note 6)		5,075,000		–
		9,234,307		5,740,085
Long-term debt (note 5)		49,865		503,475
Preferred shares (note 6)		–		5,075,000
Shareholders' equity:				
Share capital (note 7)		12,603,232		12,603,232
Contributed surplus (note 7)		315,000		100,000
Deficit		(920,083)		(1,378,695)
		11,998,149		11,324,537
Commitments (note 8)				
	$	21,282,321	$	22,643,097

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Seymour Epstein
Director

Blake Lyon
Director

Consolidated Statements of Operations

Years ended December 31		2003		2002
Revenue	$	**24,570,924**	$	28,585,702
Expenses:				
Operating		**20,834,213**		21,936,168
Depreciation and amortization		**3,573,014**		3,673,567
Interest		**505,085**		677,993
		24,912,312		26,287,728
Earnings (loss) before income taxes		**(341,388)**		2,297,974
Income taxes, future recovery (note 4)		**800,000**		400,000
Net earnings	$	**458,612**	$	2,697,974
Net earnings per Common Share, basic and diluted	$	**0.01**	$	0.07

See accompanying notes to consolidated financial statements.

Consolidated Statements of Deficit

Years ended December 31		2003		2002
Balance, beginning of year	$	**(1,378,695)**	$	(4,076,669)
Net earnings		**458,612**		2,697,974
Balance, end of year	$	**(920,083)**	$	(1,378,695)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31	2003	2002
Cash provided by (used in):		
Operations:		
Net earnings	**$ 458,612**	$ 2,697,974
Items not involving cash:		
Depreciation and amortization	**3,573,014**	3,673,567
Future income taxes, recovery	**(800,000)**	(400,000)
Stock-based compensation expense	**215,000**	100,000
Gain on settlement of note receivable	**(106,035)**	–
Other	**14,109**	(25)
Cash flow from operations	**3,354,700**	6,071,516
Change in non-cash working capital	**639,316**	132,148
	3,994,016	6,203,664
Financing:		
Repayment of long-term debt	**(3,052,619)**	(2,789,077)
Increase (decrease) in bank indebtedness	**682,155**	(710,621)
Repayment of note receivable	**448,541**	9,081
Long-term debt	**330,529**	713,992
	(1,591,394)	(2,776,625)
Investing:		
Expenditures on property and equipment	**(3,005,024)**	(2,635,852)
Increase (decrease) in cash	**(602,402)**	791,187
Cash, beginning of year	**1,053,875**	262,688
Cash, end of year	**$ 451,473**	$ 1,053,875
Supplemental information:		
Interest paid	**$ 597,513**	$ 815,658
Interest received	**$ 8,566**	$ 343

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 2003 and 2002

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation:

These financial statements include the accounts of the Company and those of its wholly-owned subsidiaries.

(b) Use of estimates and assumptions:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

(c) Foreign currency translation:

Foreign-denominated monetary assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Revenue and expenses, other than depreciation and amortization, are translated at average rates of exchange during the period. Non-monetary assets and liabilities are translated at the exchange rate in effect at the date of the transaction. Exchange gains and losses arising on the translation of monetary assets and liabilities are recorded in operations.

(d) Revenue recognition:

Revenue is recorded using the percentage-of-completion method and is based upon achieving certain measurable stages of customer projects. Work in progress is recorded at the lower of cost and estimated net realizable value.

(e) Property and equipment:

Property and equipment is recorded at cost. Depreciation is provided as follows:

Computer hardware	25% declining-balance
Computer software	3 years straight-line
Equipment and furniture	5 years straight-line
Leasehold improvements	5 years straight-line

Computer software includes development costs related to specific products or processes that are proven to be technically and economically feasible. Depreciation thereof commences at the time of capitalization. All research costs are charged to operations in the period incurred.

(f) Goodwill:

Goodwill represents the excess of the purchase price over the net identifiable assets on acquisitions and was amortized, up to December 31, 2001, on a straight-line basis over five years. The value of the residual unamortized balance is assessed at least annually with reference to various factors, principally the projected future cash flows of the businesses to which the goodwill relates.

(g) Deferred costs:

Deferred costs relate to the start-up of a new business operation and to a project previously completed. Amortization is calculated on a straight-line basis over three years.

(h) Income taxes:

The Company provides for income taxes using the asset and liability method. Under this method current income taxes are recognized for the estimated income taxes payable for the current year and future income taxes are recognized for temporary differences between the tax and accounting bases of assets and liabilities

and for the benefit of losses available to be carried forward for tax purposes that are considered more likely than not to be realized. Future income tax assets and liabilities are measured using tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. Any change to the net future income tax asset or liability is included in operations in the year it occurs.

(i) Diluted per share amounts:

Diluted per share amounts are computed using the "treasury stock" method whereby outstanding stock options and share purchase warrants are only dilutive if, and to the extent that, they are "in the money".

(j) Stock-based compensation:

The Company adopted, effective January 1, 2002, new financial accounting requirements with respect to stock-based compensation.

The Company accounts for its "market growth options" as equity instruments awarded to employees and determines compensation expense based on the fair value of the option on the grant date. Compensation expense is recognized over the expected life of the option.

2. PROPERTY AND EQUIPMENT

December 31, 2003	**Cost**	**Accumulated depreciation**	**Net book value**
Computer hardware	**$ 21,844,478**	**$ 15,562,735**	**$ 6,281,743**
Computer software	**16,580,472**	**14,386,763**	**2,193,709**
Equipment and furniture	**811,611**	**705,711**	**105,900**
Leasehold improvements	**538,461**	**427,497**	**110,964**
	$ 39,775,022	**$ 31,082,706**	**$ 8,692,316**

December 31, 2002	Cost	Accumulated depreciation	Net book value
Computer hardware	$ 20,602,135	$ 13,682,830	$ 6,919,305
Computer software	14,992,826	13,069,842	1,922,984
Equipment and furniture	730,570	674,893	55,677
Leasehold improvements	494,345	376,946	117,399
	$ 36,819,876	$ 27,804,511	$ 9,015,365

Included in computer hardware is certain equipment under capital lease with a net book value of $257,591 at December 31, 2003 ($343,456 at December 31, 2002).

3. OTHER ASSETS

	2003	2002
Goodwill	**$ 1,060,110**	$ 1,060,110
Deferred costs	**194,287**	453,336
Note receivable	**-**	942,506
	1,254,397	2,455,952
Less valuation provision	**-**	600,000
	$ 1,254,397	$ 1,855,952

(a) Deferred costs:

	2003	2002
Cost	**$ 1,275,069**	$ 1,275,069
Accumulated amortization	**1,080,782**	821,733
Net book value	**$ 194,287**	$ 453,336

(b) Note receivable:

	2003	2002
Note receivable, bearing interest at 4.5%, due in equal monthly instalments of U.S. $20,000, secured by equipment (U.S. $597,430)	**$ –**	$ 942,506

4. INCOME TAXES

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate to the earnings before income taxes. The reasons for the differences are as follows:

	2003	2002
Earnings (loss) before income taxes	**$ (341,388)**	$ 2,297,974
Combined Federal and Provincial statutory rate	**36.75%**	39.23%
Computed expense (recovery)	**$ (125,460)**	$ 901,495
Increase (decrease) resulting from:		
Recognized benefit of future income tax assets	**(1,168,481)**	(1,666,548)
Non-deductible expenses	**259,173**	230,358
Change in enacted tax rates	**159,150**	112,183
Adjustment for foreign income tax rate	**75,618**	22,512
Actual recovery	**$ (800,000)**	$ (400,000)

The components of the future income tax asset at December 31, 2003 are as follows:

	Canada	United States	Total
Non-capital/net operating losses	$ 460,000	$ 4,988,000	$ 5,448,000
Capital losses	4,375,000	–	4,375,000
Capital assets	3,693,000	(316,000)	3,377,000
Resource properties	1,752,000	–	1,752,000
Other	1,464,000	98,000	1,562,000
	$ 11,744,000	$ 4,770,000	16,514,000
Less valuation allowance			14,714,000
Future income tax asset			$ 1,800,000

The non-capital and net operating loss carryforwards reflected above expire as follows:

Canada	Non-capital losses
2006	$ 1,329,000

United States	Net operating losses
2009	U.S.$ 2,500,000
2010	1,200,000
2011	2,300,000
2019	300,000
2020	2,000,000
2021	830,000
2022	160,000
2023	1,946,000
	U.S.$ 11,236,000

5. BANK CREDIT FACILITY AND LONG-TERM DEBT

The Company has a bank operating line of credit of $5,000,000, a bank capital term facility of up to $1,500,000 and a U.S. $1,000,000 line of credit for foreign exchange contract contingencies. All bank borrowings are secured by a general security agreement and the assignment of all intellectual property.

Long-term debt consists of the following:

	2003	2002
Bank term loan, due in monthly instalments of $73,333, with interest at prime plus 1.90% to 2.15% depending on fixed coverage ratio; maturing in April 2004	**$ 245,603**	$ –
Bank term loan, due in quarterly instalments of $400,000 to December 2003, with interest at 8.07%; converted to new bank term loan in April 2003	–	1,600,000
Bank capital term loan, due in monthly instalments of $50,000 and maturing in August 2004, with interest at prime plus 2% to 2.25% depending on fixed coverage ratio; converted to new bank term loan in April 2003	–	955,072
Bank term loan, due in monthly instalments of U.S. $20,834, with interest at U.S. base rate plus 2% to 2.25% depending on fixed coverage ratio (2002 - U.S. $187,482); matured in September 2003	–	295,772
Capital leases, due in monthly instalments of $11,482 including interest, maturing in 2004 through 2005, bearing interest at a weighted average rate of 10.0%	**144,623**	261,471
	390,226	3,112,315
Less current portion, included in current liabilities	**340,361**	2,608,840
	$ 49,865	$ 503,475

Scheduled repayments of long-term debt are as follows:

2004	$ 340,361
2005	49,865
	$ 390,226

Interest paid on long-term debt during the years ended December 31, 2003 and 2002 amounted to $175,236 and $348,118, respectively.

6. PREFERRED SHARES

The Company has issued 7,807,692 Series A Convertible Senior Preferred Shares at $0.65 per share. Each Preferred Share is convertible, at the option of the holder, into one Common Share and $0.10 cash at any time up to November 5, 2004. On November 5, 2004 all outstanding Preferred Shares must be redeemed at a price of $0.65 per share.

Dividends are cumulative and fixed at 6.5%. Dividends of $329,875 were paid in each of 2003 and 2002 and have been included in interest expense in the statements of operations.

7. SHARE CAPITAL

(a) Authorized:

Unlimited number of Common Shares

Unlimited number of Senior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

Unlimited number of Junior Preferred Shares, the rights, privileges, restrictions and conditions attached to each series thereof to be determined by the Board of Directors prior to issuance.

(b) Issued:

	Number of Common Shares	Amount
Balance, December 31, 2001	39,048,011	$ 12,603,232
Issued on exercise of options	62,285	–
Balance, December 31, 2002	39,110,296	12,603,232
Issued on exercise of options	368,798	–
Cancelled on surrender of shares	(5,972)	–
Balance, December 31, 2003	39,473,122	$ 12,603,232

(c) Options:

The Company has a share option plan under which employees, officers and directors are eligible to receive options to acquire Common Shares, subject to a limit of 6.8 million shares. At December 31, 2003 the number of options outstanding was 4,240,180 at prices ranging from $0.25 to $0.66 per share and expiring on various dates to December 14, 2007. Changes in options are summarized as follows:

	2003		2002	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price
Outstanding, beginning of year	**5,823,531**	**$ 0.54**	4,885,832	$ 0.62
Granted	**300,000**	**0.54**	1,944,555	0.61
Exercised	**(368,798)**	**0.35**	(62,285)	0.36
Cancelled	**(1,514,553)**	**0.70**	(944,571)	1.19
Outstanding, end of year	**4,240,180**	**$ 0.51**	5,823,531	$ 0.54
Exercisable, end of year	**2,626,689**	**$ 0.51**	2,886,604	$ 0.58

The following summarizes information regarding the options outstanding at December 31, 2003:

	Options outstanding			Options exercisable	
Range of exercise prices	Weighted average remaining life	Number	Weighted average exercise price	Number	Weighted average exercise price
$0.25 to $0.50	18 months	1,604,016	$ 0.37	1,126,195	$ 0.36
$0.51 to $0.66	24 months	2,636,164	$ 0.60	1,500,494	$ 0.61
$0.25 to $0.66	22 months	4,240,180	$ 0.51	2,626,689	$ 0.50

All of the 4,240,180 options outstanding are in the form of "market growth options" whereby the option holder makes no payment to the Company but instead receives a reduced number of Common Shares, calculated in relation to the difference between the current market price of the shares and the exercise price thereof.

The weighted average fair value of stock options granted during the year was $0.54 on the grant date using the Black-Scholes option pricing model with the following weighted assumptions: risk-free interest rate of 2.29%, expected life of four years and expected volatility of 63%. The Company recognized compensation expense of $215,000 for stock-based employee compensation awards with a corresponding recognition of contributed surplus during 2003. The corresponding amount was $100,000 in 2002.

(d) Warrants:

At December 31, 2003 there were warrants outstanding with a former debenture holder to acquire 3,090,534 Common Shares at prices ranging from $0.41 to $1.92, expiring on various dates to June 5, 2006.

(e) Per share information:

Per Common Share amounts are calculated based on the weighted average number of Common Shares outstanding during the years ended December 31, 2003 and 2002 of 39,174,341 and 39,079,636, respectively.

8. COMMITMENTS:

Future minimum payments relating to operating leases are as follows:

2004	$	1,397,648
2005		935,272
2006		519,261
2007		459,246
2008		455,888

9. FINANCIAL INSTRUMENTS:

(a) Interest rate risk:

The Company is exposed to interest rate fluctuations in respect of its long-term debt and drawings under its other bank credit facilities.

(b) Foreign currency risk:

The Company is exposed to foreign currency fluctuations in respect of its operations in the United States.

During 2003 the Company entered into a forward exchange contract which expired during the year and resulted in a gain of $913,500. The Company elected to not account for this contract as a hedge, as defined under Canadian generally accepted accounting principles, such that it was marked-to-market during the contract period.

The Company recorded a net foreign currency gain of $86,948 in 2003 and a foreign currency loss of $10,837 in 2002. The net gain in 2003 reflects the above-mentioned gain on the forward exchange contract less the foreign exchange loss that otherwise occurred.

(c) Credit risk:

The Company's revenue is largely derived from well-established customers such that credit risk is not considered significant.

(d) Fair values:

The fair values of all monetary assets and liabilities at December 31, 2003 approximate their book values.

10. RELATED PARTY TRANSACTIONS:

The majority of the preferred shares described in note 6 are held by a company related to the Company's major shareholder. Dividends paid in this regard amounted to $281,125 (2002 - $264,163).

During 2003 fees of $39,595 (2002 - $40,219) were paid to a company related to the Company's major shareholder for accounting services provided.

11. SEGMENTED INFORMATION:

Based on the Company's internal management reporting structure, operating segments have been established for (a) Seismic Processing - reflecting the processing of customers' seismic data - and (b) Data Archiving - reflecting the storage of seismic and other data, in electronic and hard copy formats, with on-line access capabilities. The point of origin of revenues and the location of assets determine the geographic areas.

Industry information:

December 31, 2003	**Seismic Processing**	**Data Archiving**	**Total**
Revenue	**$ 18,845,233**	**$ 5,725,691**	**$ 24,570,924**
Operating expenses	**16,091,030**	**4,743,183**	**20,834,213**
Depreciation and amortization	**2,552,598**	**1,020,416**	**3,573,014**
Segment earnings (loss)	**$ 201,605**	**$ (37,908)**	**163,697**
Interest			**505,085**
Loss before income taxes			**$ (341,388)**
Expenditures on property and equipment	**$ 2,330,866**	**$ 674,158**	**$ 3,005,024**
Total assets	**$ 15,965,539**	**$ 5,316,782**	**$ 21,282,321**

December 31, 2002	Seismic Processing	Data Archiving	Total
Revenue	$ 21,388,353	$ 7,197,349	$ 28,585,702
Operating expenses	16,385,300	5,550,868	21,936,168
Depreciation and amortization	2,651,570	1,021,997	3,673,567
Segment earnings	$ 2,351,483	$ 624,484	$ 2,975,967
Interest			677,993
Earnings before income taxes			$ 2,297,974
Expenditures on property and equipment	$ 1,760,039	$ 875,813	$ 2,635,852
Total assets	$ 17,085,543	$ 5,557,554	$ 22,643,097

Geographic information:

December 31, 2003	**Canada**	**United States**	**Total**
Revenue	**$ 15,247,951**	**$ 9,322,973**	**$ 24,570,924**
Property and equipment	**5,156,792**	**3,535,524**	**8,692,316**
Goodwill	**–**	**1,060,110**	**1,060,110**

December 31, 2002	Canada	United States	Total
Revenue	$ 16,795,422	$ 11,790,280	$ 28,585,702
Property and equipment	5,462,592	3,552,773	9,015,365
Goodwill	–	1,060,110	1,060,110

During 2003 the Company generated 10% (2002 – 14%) of its revenue from a single customer.

Corporate Information

Board of Directors
John R. Butler, Jr. [1,3]
Senior Chairman,
J. R. Butler & Company

Seymour Epstein [3]
Chairman,
Seymour Epstein Enterprises Inc.

Blake D. Lyon [2]
Senior Vice-President and CFO,
Seymour Epstein Enterprises Inc.

Richard F. Miles [1,2]
President and CEO
Grant Geophysical

Francis P. McGuire [1]
President and CEO,
Major Drilling Group
International Inc.

David A. Richard
President and CEO,
Kelman Technologies Inc.

Paul D. Watson [2,3]
Vice-President, Exploration
TRAFINA Energy Ltd.

[1] Member of the Audit Committee

[2] Member of the Compensation Committee

[3] Member of the Corporate Governance Committee

Officers
Seymour Epstein
Chairman of the Board

David A. Richard
President and CEO

Brian H. Link
Senior Vice-President and
General Manager,
Geophysical Processing

Neil S. Baker
Vice-President,
Data Management and Archives

Debbie L. Garbutt
Vice-President, Controller

Blake D. Lyon
Chief Financial Officer

Patrick J. McKenny
Vice-President,
Marketing and Sales

John A. Paul
Vice-President,
Administration and Secretary

Vivian R. Martin
Assistant Secretary

Annual Meeting
The Annual and General Meeting of Kelman Technologies, Inc. will be held on June 14, 2004 at 10 a.m. in the McBride Room of the Toronto Marriott Hotel, 90 Bloor Street East, Toronto, Ontario. All Shareholders and interested parties are cordially invited to attend.

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Toronto Stock Exchange
Stock Listing Symbol: **KTI**

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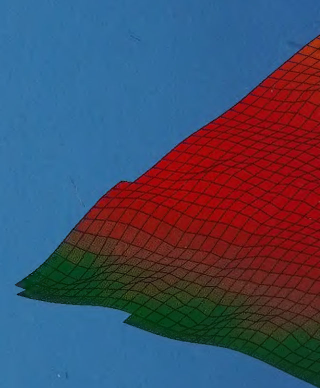

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